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LARRY WALKER
Auditor/Controller-Recorder
County Clerk

ELIZABETH A. STARBUCK
Assistant Auditor/Controller-Recorder
Assistant County Clerk

May 18, 2006

RICHARD LARSEN
Treasurer/Tax Collector
172 West Third Street
San Bernardino, CA 92415-0360

SUBJECT: MANAGEMENT LETTER REGARDING INTEREST APPORTIONMENT AUDIT

We have audited the interest apportionments of the San Bernardino County Treasurer's Office for the fiscal year ending June 30, 2005 and have issued our report thereon dated May 18, 2006. In planning and performing our audit of the interest apportionments, we considered internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the gross interest apportionment.

An audit does not include examining effectiveness of internal control and does not provide assurance on internal control. However, we noted a certain matter involving internal control and its operation, which is presented below, that we do not consider to be a reportable condition under standards presented by the American Institute of Certified Public Accountants. Reportable conditions involve matters that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the audit report. We have not considered internal control since the date of our report.

The finding and recommendation listed below is presented for your consideration. This finding and recommendation has been discussed with the appropriate members of management, and is intended to improve internal controls over the interest apportionment process.

FINDINGS AND RECOMMENDATIONS

FINDING 1: The Treasurer's Office process for deducting administrative costs does not fully comply with California Government Code Section 27013 and the Treasurer's Investment Policy.

Pursuant to the California Government Code 27013 and the Treasurer's Investment Policy, the County Treasurer is allowed to deduct the actual administrative costs from pooled fund investment earnings.

Labor costs for Treasurer-Tax Collector's Office personnel engaged in the investment process are included in these administrative costs. However, the Treasurer's Office uses budgeted instead of actual labor costs.

Actual allocated costs of $994,858 were overstated by $9,628 (0.97%) for the 2005 Interest Apportionment.

However, the risk of material misstatement exists until the process is based on actual costs. A material misstatement in the interest apportionment process could result in litigation, correction costs, increased oversight, and a loss of public confidence

Recommendation:

In order to fully comply with the Government Code Section 27013 and the Treasurer's Investment Policy, a process allocating actual administrative costs from interest earnings should be implemented. The Treasurer's Office should establish labor distribution codes to track salary and benefit costs related to pooled investment fund activities. Additionally, written procedures and training for proper coding should be established. As a direct result, labor costs charged to the pooled investment process would be captured and reviewed by management each pay period without creating a separate internal control procedure. Another benefit is to reduce the scope of the Treasurer's investment pool cost allocation study.

Management's Response:

The Treasurer's Office has implemented a process for allocating actual salaries and benefits costs beginning with fiscal year 2005/06. The prior calculation method utilized budgeted salaries and benefits costs adjusted for position vacancies. Although the prior allocation method was based on these adjusted salaries and benefits costs instead of actual costs, analysis of fiscal year 2004/05 shows the difference between these two methods to amount to less than .5% of the total administrative costs of the investment pool.

FINDING 2: The Treasurer's investment pool cost allocation percentages are based on estimated costs and has not been updated since FY 2002/2003.

The Treasurer's investment pool cost allocation percentages were based on estimated amounts of time spent on various parts of the Treasury pool activities and were determined in June 2003 by VTD, Vavrinek, Trine, Day & Co., LLP, except for the new positions or duty changes after June 2003. In the case of new positions and duty changes, the Treasurer's Office estimated the time spent on treasury pool activities to determine the percentages.

The allocation percentages determined in June 2003 were outdated for the 2005 interest apportionment, since there were new positions and duty changes. Although, the duty changes did not significantly affect the costs of managing the investments. Using outdated allocation percentages instead of the actual costs could affect the accuracy of the Treasury pool management costs charged to the interest apportionment process.

Recommendation:

To improve the accuracy and completeness of the cost allocation, the model/study should be updated at least every other fiscal year. Also, actual costs instead of estimated costs should be used when allocating percentages.

Management's Response:

The Treasurer's Office has hired the CPA firm, Vavrinek, Trine, Day and Co., LLP to update the Treasury pool cost allocation. The cost allocation will be updated every other fiscal year and will be applied to actual, not estimated, costs. Although the most recent update of the Treasury pool cost allocation was performed in June of 2003, the duties of the employees involved in treasury pool activities have not significantly changed since that time.

Acknowledgements:

We wish to thank management and staff for their full cooperation during the audit.

Respectfully submitted,

Larry Walker
Auditor/Controller-Recorder

By:

Andrea Cook
Internal Auditor II

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